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IN THE

Supreme Court of the United States

OCTOBER TERM, 1975.

No. 75-780

CONTINENTAL ILLINOIS NATIONAL BANK AND TRUST COMPANY OF CHICAGO,
Petitioner,

vs.

MOLLIE NUSSBACHER,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

Petitioner Continental Illinois National Bank and Trust Company of Chicago (hereinafter "Continental Bank") respectfully prays that a writ of certiorari issue to review the decision of the Court of Appeals for the Seventh Circuit handed down on July 15, 1975.

OPINIONS BELOW.

The opinion of the Court of Appeals, reversing the decision of the District Court, which had dismissed the amended derivative complaint herein, is reported at 518 F. 2d 873. (*See*, Appendix, page A15.) The two opinions of the District Court dismissing the original and amended derivative complaints for failure to comply with Rule 23.1, F. R. Civ. P. (which requires

a stockholder seeking to sue derivatively on behalf of a corporation to make a prior demand upon the corporation's board of directors so that they may exercise their business judgment with regard to the propriety of bringing suit), are reported at 61 F. R. D. 399 and 61 F. R. D. 403, and are also reported in summary form at CCH Fed. Sec. L. Rept., ¶ 94,867 ('74-'75 Trans. Bind.). (*See*, Appendix, pages A6, A10.)

JURISDICTION.

The judgment of the Court of Appeals was entered on July 15, 1975, a timely petition for rehearing and suggestion for rehearing *en banc* were denied on September 24, 1975, and this petition for writ of certiorari is being filed within 90 days of that date. The jurisdiction of this Court is invoked under 28 U. S. C. § 1254(1).

QUESTIONS PRESENTED.

1. Is mere "opposition" by the board of directors to the proposal of a stockholder that suit be brought by the corporation against a third party sufficient ground to excuse the requirement of prior demand upon the board and to vest the stockholder with authority to maintain derivative litigation which is deemed by the board, in the exercise of its business judgment, to be based upon a distortion of the facts, to be unethical, and to be injurious to the welfare of the corporation?

2. Is mere prior "participation" by the board of directors in a transaction which the stockholder seeks to make the basis for suit against a third party sufficient ground to ignore the business judgment of the board where the District Court has held, and the Court of Appeals has not questioned, that the derivative complaint alleges no facts indicating that the directors have acted in their own self-interest, under external influence or domination, or in violation of any law?

RULE OF CIVIL PROCEDURE INVOLVED.

Rule 23.1, Federal Rules of Civil Procedure, states in pertinent part:

> "In a derivative action brought by one or more shareholders or members to enforce a right of a corporation or of an unincorporated association, the corporation or association having failed to enforce a right which may be properly asserted by it, the complaint shall be verified and shall allege . . . with particularity the efforts, if any, made by the plaintiff to obtain the action he desires from the directors or comparable authority and, if necessary, from the shareholders or members, and the reasons for his failure to obtain the action or for not making the effort. The derivative action may not be maintained if it appears that the plaintiff does not fairly and adequately represent the interests of the shareholders or members similarly situated. . . ."

STATEMENT OF THE CASE.

Petitioner Continental Bank seeks review of the decision of the Court of Appeals for the Seventh Circuit reversing the decision of the District Court which had dismissed the amended derivative complaint herein. The District Court had held that the derivative complaint alleged no facts which would warrant depriving the board of directors of control over the present litigation. On appeal, the Seventh Circuit held that mere opposition by the board of directors to the maintenance of the instant litigation presented sufficient reason to disregard the business judgment of the board, to excuse as "fruitless or futile" the requirement of prior demand, and to allow the stockholder to proceed with the litigation on a derivative basis.

On February 27, 1973, plaintiff-respondent, a stockholder of Leasco Corporation (hereinafter "the stockholder"), filed a derivative complaint in the District Court for the Northern District of Illinois, purporting to be brought on behalf of Leasco

Corporation and against Continental Bank. Named as defendants in addition to Continental Bank were certain directors of Leasco Corporation.* However, on the express instructions of the stockholder, those directors were never served with process and to this day have not been brought into the instant litigation. *See,* Appendix, pages A16, A8.

The derivative complaint alleged "on information and belief" that Continental Bank had "extended credit" to Leasco Corporation in violation of the margin regulations of the Federal Reserve Board which limit the amount of credit a bank may extend to a borrower to invest in securities where the loan is secured by stock. 12 C. F. R. § 221. The supposed "extension of credit" consisted of a transaction wherein the trust department of Continental Bank had purchased from third parties certain Leasco stock and warrants issued in connection with a corporate takeover; two years later, those same securities were resold by Continental Bank's trust department to Leasco Corporation pursuant to a pre-existing written agreement. The novel allegations of the complaint analogized this transaction to a temporary "extension of credit" to Leasco, "secured" by the Leasco stock and warrants. *See,* Appendix, pages A2, A3. The derivative complaint asserted an implied cause of action under the margin regulations in favor of Leasco, praying that Continental Bank be required to rescind the transaction and account for any losses suffered by Leasco.

The derivative complaint admitted that no demand upon Leasco Corporation's board of directors had been made by the stockholder proposing suit, but recited that demand would be useless or futile in the premises.

Leasco Corporation filed an answer to the derivative complaint, denying that the transaction challenged in the complaint was an "extension of credit" and denying that the complaint had alleged any ground for by-passing the board of directors

* The stockholder also named her corporation, Leasco, as a defendant, because this purports to be a derivative proceeding brought by the stockholder to assert on behalf of the corporation an alleged right of action against a third party (Continental Bank).

on the question whether suit should be pressed against Continental Bank on such a claim. Having never been served with process, the directors of Leasco Corporation did not file appearances and did not file answers to the derivative complaint.

On April 10, 1973, Continental Bank filed a motion to dismiss the derivative complaint, based on Rule 23.1, F. R. Civ. P. (quoted on page 3 above), and supported by the affidavit of Saul P. Steinberg, Chairman of the Board of Directors of Leasco Corporation. *See,* Appendix, pages A1-A4. That affidavit, *inter alia,* asserted that the transaction challenged in the complaint had in no manner injured Leasco Corporation, but rather had benefited it substantially. The affidavit stated further that the derivative litigation proposed by the stockholder was detrimental to the best interests of the corporation, and was accompanied by a resolution of the Board of Directors of Leasco Corporation disapproving the instant derivative litigation, and stating that the litigation was harmful to the welfare of the corporation.* *See,* Appendix, page A5.

On July 16, 1973, the District Court dismissed the original derivative complaint, reasoning as follows in accordance with long-established principles of law:

> "The rationale of the Rule 23.1 demand requirement is that the corporate board of directors, exercising their

* Leasco's Chairman of the Board explained that it would be a "gross distortion of the facts" to contend that Leasco had suffered injury as a result of the supposed "extension of credit." Mr. Steinberg also affirmed that "Leasco participated in the transaction which is the subject of this action upon the understanding that it was no more than what it appeared to be, namely an exchange and purchase of securities. It was not a disguised loan . . ." Mr. Steinberg added: "In my view, the long-term interest of our shareholders will be best served by our maintaining a position of inflexible integrity and a fair dealing in our relations with the financial community; I would have considered it wholly inconsistent with this position for my Company to have participated in this attempt to collect some money from the defendants on the grounds pressed by the Plaintiff." *See,* Appendix, pages A2-A4. The Board of Directors unanimously concluded that the derivative action proposed by the stockholder "was contrary to business ethics and that for the corporation to have initiated such action would have been damaging to its credit and standing in the financial community." Appendix, page A5.

reasonable and good faith business judgment, possesses the paramount right to corporate control and management. [Citations omitted.] The power and right to invoke judicial sanctions to rectify corporate injuries resides in the board of directors and represents an integral aspect of their duties."

"While excuse of demand is wholly within the sound discretion of the trial court [citations omitted], it is usually limited to cases where the directors wrongfully refuse to pursue corporate rights or are personally involved in the wrongdoing. [Citations omitted.] Indeed, mere approval of corporate action, absent self-interest or bias, cannot be the basis for establishing director misconduct since directors are afforded such considerable latitude in managing their corporations. [Citations omitted.] To hold otherwise would be to strip Rule 23.1 of any logical meaning."

"Thus, before a court will dislodge control from its rightful possessors [the corporate directors], the complaining shareholder must show that his complaint is an exceptional one. This burden rests squarely with the plaintiff and may be raised by any party to the action." Appendix, page A8. [Citations omitted.]

On September 10, 1973, the stockholder filed an amended derivative complaint, alleging that the directors of Leasco Corporation were incapable of exercising unbiased business judgment because they themselves supposedly might be held liable in the instant action as "aiders and abettors" of the alleged illegal extension of credit.* On December 18, 1973, the District Court once again dismissed the derivative complaint, holding as a matter of law that the amended complaint was insufficient on its face:

"Plaintiff's position is an untenable attempt to bootstrap herself over the hurdles placed in her path by Fed. R. Civ. P. 23.1. *See In Re Kauffman Mutual Fund Actions*, 479 F.2d 257, 264 (1st Cir. 1973), cert. denied, ... U.S.

* The stockholder raised this charge even though she had specifically instructed the marshal's office not to serve the directors with process or bring them into the instant litigation. *See*, Appendix, pages A16, A8.

> ....., 42 U.S.L.W. 3178 (Oct. 9, 1973). . . . In my previous opinion, I observed that 'mere approval of corporate action, absent self-interest or bias, cannot be the basis for establishing director misconduct' sufficient to excuse a shareholder from having to formally demand that the board enforce an alleged right of the corporation. Furthermore, I held that broad and conclusory allegations of wrongdoing by the directors which are unsupported by underlying facts are not adequate to excuse the requirements of Rule 23.1."
>
> "Plaintiff has failed to repair the defects in her original complaint. She presently alleges in her subparagraph 32-B that the Leasco Board participated, and aided and abetted, in the alleged illegal loan in this case, that, as a result, they are personally liable to the corporation, and that therefore they are sufficiently biased so as to excuse the requirement of Rule 23.1. This is clearly not enough, since, in the first place, the directors are *not* personally liable under the law as it existed at the time of the loan in question; and, in the second place, the remaining allegations merely state that the directors, in their official capacity, 'participated in and aided and abetted' in the illegal loan. Thus, plaintiff fails to allege any underlying facts indicating self-interest or bias in the board of directors which would excuse demand that it take on the suit; and the same is true of subparagraphs 32-C and D of the amended complaint. They all utterly fail to allege specific, underlying facts indicating any self-interest or bias in the directors which would justify wresting from them their power and right to determine whether to enforce a right of the corporation. Plaintiff therefore fails to meet the demand requirements of Fed. R. Civ. P. 23.1, and therefore defendant's motion to dismiss must be granted with prejudice. Such dismissal shall, of course, have no *res judicata* effect as far as the *merits* of the case are concerned. Rather, it affects only the issue of demand or excuse thereof under Rule 23.1." Appendix, pages A13-A14. (Emphasis in original; footnote citations omitted.)

On appeal, the Court of Appeals for the Seventh Circuit reversed the above-quoted decision of the District Court. The Court of Appeals reasoned that mere opposition by Leasco's

board of directors to the maintenance of this derivative litigation was a ground for by-passing them and permitting the stockholder to plunge ahead: "[S]uffice it to say, the message is loud and clear that under no circumstances would the board of directors have approved the corporation bringing the action. . . . . Here, it was apparent that the board members were inflexible in their position that corporate action against the defendant would not be taken." Appendix, page A24. The opposition of the board, the Seventh Circuit ruled, would make any reference to them of the question whether suit should be brought "an effort which would be fruitless or futile." Appendix, page A21. In reaching that conclusion, the Court of Appeals stated that it was unnecessary to determine whether the stockholder had alleged with particularity any ground for concluding that the directors were incapable of exercising "business judgment," and also stated that it was unnecessary to inquire on a dismissal motion whether or not "this is a case of the 'special character which stockholders may bring.' "* Appendix, pages A22-A23.

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* In a footnote to its opinion, the Seventh Circuit suggested that the prior "participation" of Leasco's directors in the transaction which the stockholder sought to make the basis for suit against Continental Bank might have the effect of diminishing their business judgment. However, the Seventh Circuit stated that the question whether the stockholder had alleged sufficient facts indicating the inability of the board to exercise business judgment should be determined, not on a dismissal motion, but rather in a summary judgment hearing or, perhaps, a plenary trial on the merits. *See,* Appendix, page A23. The knotty procedural implications and complications which would be engendered by that suggestion were not addressed by the court.

REASONS FOR GRANTING THE WRIT.

I. The Interpretation of Rule 23.1 Adopted by the Seventh Circuit in the Instant Case Conflicts Directly with the Decisions of This Court on the Same Subject, and Conflicts Directly with the Recent Decision of the First Circuit in In Re Kauffman Mutual Fund Actions.

In its decision below, the Seventh Circuit has abandoned the legal restrictions prescribed by this Court, and by other Courts of Appeals over the years, as safeguards to prevent abuse of derivative litigation in the federal district courts. The Seventh Circuit has failed to recognize that it is the board of directors of a corporation, not individual stockholders thereof, which is vested with authority to make decisions of policy on behalf of the corporation, including the decision whether suit should be brought by the corporation against a third party.*

The Seventh Circuit has also failed to recognize that the board of directors is equally empowered to decide *not* to sue, and a decision not to sue may not be challenged in a court of equity by a single stockholder unless that stockholder alleges specific facts in the derivative complaint establishing that the directors are biased against the corporate interest and are incapable of exercising unbiased business judgment. Mere "opposition" by the board of directors to the proposed litigation is not a ground for stripping them of authority to decide upon the wisdom of bringing suit. To the contrary, opposition by the board may be the highest expression of sound business judgment. Nor is resort to the board "fruitless or futile" simply because the board, in the exercise of business judgment, declines to sue. In such case, the board executes its duty by determining conclusively, in light

* The Delaware statute assigning authority in Leasco Corporation reads as follows: "The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a Board of Directors, except as may be otherwise provided in this chapter or in its certificate of incorporation." Del. Code Ann. Title 8, Ch. 1, § 141(a).

of the business considerations involved, the position of the company with regard to the litigation proposal.*

Nor is there validity to the suggestion of the Seventh Circuit that the directors should be by-passed where some of them have previously "participated" in the business transaction which the stockholder wishes to make the basis for suit. In most cases, of course, the board of directors will have participated in or approved all of the major business transactions of the company. That is their function and duty. When a stockholder subsequently proposes litigation based on a business transaction of this kind, the duty of the directors is not extinguished, but rather, refocused. It is for the directors who have familiarity with the transaction, familiarity with those who have conducted it and familiarity with its record of success or failure, to determine whether the facts warrant suit against a third party.** In the absence of allegations of bias or self-dealing, mere prior "participation" or "approval" does not warrant wresting control of corporate litigation from the directors. If the derivative complaint fails to allege facts establishing the inability of the board to exercise unbiased business judgment on the subject of litigation, it is defective on its face and should be dismissed without compelling the corporation and the third party defendant to endure the expense and vexation of extensive pre-trial proceedings and a lengthy trial on the merits.

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* Here, the board of directors has already expressed its opposition to the proposed litigation, and there is no factual dispute as to that opposition. *See,* Appendix, pages A1-A5. Thus, the key question is whether the stockholder can wrest control of corporate litigation from the directors in absence of factual allegations demonstrating their inability to perform their duty. The "demand" requirement which is here at issue, then, is not only the preliminary requirement of petitioning the board of directors (which the stockholder here omitted to do), but also the broader substantive requirement that the stockholder demonstrate in the derivative complaint that there is an equitable basis for judicial intervention, and that, due to extraordinary circumstances, the business judgment of the directors (which it is the purpose of the "demand" to invoke) must be set aside.

** *See, e.g., In Re Kauffman Mutual Fund Actions,* 479 F. 2d 257, 265-267 (1st Cir. 1973), discussed on pages 15-18 below.

A. *Supreme Court Decisions in Conflict with the Seventh Cicruit Decision Herein.* The landmark decision on this point is *Hawes* v. *Oakland,* 104 U. S. 450 (1881).* In that case, the stockholder sued his corporation and the City of Oakland derivatively, alleging that his corporation had wasted assets by providing services for the City free of charge. The City of Oakland demurred to the bill; the bill was dismissed; and this Court affirmed the dismissal. The Court refused to characterize the case before it as a case so "exceptional" in its character as to call for the "extraordinary powers of a court of equity." *Id.* at 454. Quoting from an earlier English precedent which contained "the best assertion of the rule" of business judgment, this Court stated:

> " '. . . there may be a great many wrongs committed in a company, —there may be claims against directors, there may be claims against officers, there may be claims against debtors; there may be a variety of things which a company may well be entitled to complain of, but which, as a matter of good sense, they do not think it right to make the subject of litigation; and it is the company, as a company, which has to determine whether it will make anything that is a wrong to the company a subject-matter of litigation . . .' " *Id.* at 457.

The discretion of the directors to decline suit exists, the Court ruled, except where the directors act fraudulently, *ultra vires,* or in their self interest. *Id.* at 460. Therefore, as a corollary of the directors' discretion to sue or not sue, the Court stated that no derivative action would be entertained if the stockholder had not made a *demand* upon the directors, an "earnest, not a simulated effort, with the managing body of the corporation, to induce remedial action on their part, and this must be made apparent to the court." *Id.* at 461.

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* *Hawes* v. *Oakland* was the first decision of this Court to outline the prerequisites of derivative litigation. The teachings of that case were subsequently codified in Federal Equity Rule 94, which is a predecessor of the modern Rule 23.1. *See generally, In Re Kauffman Mutual Fund Actions,* 479 F. 2d 257, 263 (1st Cir. 1973).

Furthermore, this Court in *Hawes* made quite clear that prior "participation" by the directors in the transaction which the stockholder seeks to make the basis for derivative litigation is a factor *favoring* deference to their business discretion. In *Hawes*, the stockholder asserted that, immediately prior to filing suit, he had requested the directors to "desist from their illegal and improper practices. . ."; that the directors had declined the request; and that the directors had threatened to continue their prior policies. 104 U. S. 451. Notwithstanding these charges of improper "participation" by the directors, this Court upheld their business discretion, noting that it may be the "exercise of the highest wisdom" to conduct the affairs of the corporation in that manner, and that the directors, with their prior experience with the transaction in question, were "better able to act understandingly on this subject than a stockholder residing in New York." 104 U. S. 462.

The doctrines of *Hawes* v. *Oakland* run consistently throughout the decisions of this Court in succeeding decades. *See, e.g., Detroit* v. *Dean*, 106 U. S. 537, 541-542 (1882) (in order to wrest control from directors who disapprove suit, the stockholder must show a "clear breach of duty on their part in neglecting or refusing to act in the matter, amounting to such grossly culpable conduct as would lead to irremediable loss . . ."). *Accord*: *Dimpfell* v. *Ohio and Mississippi R. Co.*, 110 U. S. 209, 211 (1884) ("It is not enough that there may be a doubt as to the authority of the directors or as to the wisdom of their proceedings.").

The decision of the Court in *Corbus* v. *Gold Mining Co.*, 187 U. S. 455 (1903), restates the basic rule:

> "It must not be understood that a mere technical compliance with the foregoing rule [the predecessor of Rule 23.1 requiring demand] is sufficient and precludes all inquiry as to the right of the stockholder to maintain a bill against the corporation. This Court will examine the bill in its entirety and determine whether, under all the circumstances, the plaintiff has made such a showing of wrong

> on the part of the corporation or its officers and injury to himself as will justify the suit. *The Directors represent all the stockholders and are presumed to act honestly and according to their best judgment for the interests of all. Their judgment as to any matter lawfully confided to their discretion may not lightly be challenged by any stockholder or at his instance submitted for review to a court of equity.*" *Id.* at 463. (Emphasis added.)

And this Court made quite clear that the directors have discretion to decline the litigation altogether:

> "The directors may sometimes properly waive a legal right vested in the corporation in the belief that its best interests will be promoted by not insisting on such right. They may regard the expense of enforcing the right or the furtherance of the general business of the corporation in determining whether to waive or insist upon the right. And *a court of equity may not be called upon at the appeal of any single stockholder to compel the directors of the corporation to enforce every right which it may possess, irrespective of other considerations.* It is not a trifling thing for a stockholder to attempt to coerce the directors of a corporation to an act which their judgment does not approve, or to substitute his judgment for theirs." *Id.* at 463. (Emphasis added.)

Accord: *Wathen* v. *Jackson Oil Co.*, 235 U. S. 635, 638-641 (1915) (despite charges that the directors had approved a policy of complying with an unconstitutional statute which threatened to render the company "insolvent" and its property "valueless" and that the directors were motivated by personal "fear" of "enormous penalties" and legal sanctions which deprived them of business judgment, this Court held that the stockholder's grounds for wresting control from the directors were "palpably inadequate"). *See also, United Copper Co.* v. *Amal. Copper Co.*, 244 U. S. 261, 263-264 (1917) (per Justice Brandeis, holding that a stockholder ought not be permitted "to interfere with the internal management of the corporation," and that "[w]hether or not a corporation shall seek to enforce in the courts a cause of action for damages [here an

action based on the Sherman antitrust law] is, like other business questions, ordinarily a matter of internal management and is left to the discretion of the directors").

In its most recent decision upon the precise question here raised, this Court found it necessary to correct the Seventh Circuit for making the very same mistake of law which it has made once again in the instant case. *See, Swanson* v. *Traer,* 354 U. S. 114 (1957). There, Justice Douglas, writing for the Court, noted that the District Court had dismissed the complaint upon motion of defendant because: ". . . no showing had been made that the refusal of the management to act to redress the alleged wrong was not a decision entrusted to the good-faith judgment of the directors. In other words, the District Court concluded that the controversy did not fall within the exceptional group of cases where the stockholder may dispute the management and take the reins of corporate litigation in his own hands." 354 U. S. 115. At the appellate level in *Swanson,* when the case first reached the Seventh Circuit, that Court deemed it unnecessary to reach the question decided by the District Court, deciding instead (and incorrectly) that the complaint should be dismissed for lack of diversity of citizenship. This Court therefore remanded the case to the Seventh Circuit for the explicit purpose of considering the question which that court had not reached—the sufficiency of plaintiff's *in limine* showing: "There remains for consideration the question ruled on by the District Court and which the Court of Appeals did not reach, *viz.*, whether this suit is of that exceptional character which stockholders may bring" in contravention of the business judgment of the directors who were "definitely and distinctly opposed to the institution of this litigation." 354 U. S. 116-117. This Court specifically directed the Seventh Circuit to review the rule of prior demand set forth in the "classical" case of *Hawes* v. *Oakland,* 104 U. S. 450 (1881), which it had failed to consider. In compliance with the mandate of this Court, the Seventh Circuit thereupon applied the teaching

of the Supreme Court decisions cited above and affirmed the dismissal order originally entered by the District Court, holding:

> "*A corporation's right not to sue is correlative to its right to sue.* Unless an equitable basis for intervention be shown, an individual stockholder has no more right to challenge by a derivative suit a decision by the board of directors not to sue than to so challenge any other decision by the board." 249 F. 2d 859. (Emphasis supplied.)

The Court of Appeals noted further:

> "It is obvious that the requirement that a stockholder, before filing a derivative action on behalf of his corporation, must first demand of its board of directors that it cause such an action to be instituted, does not mean that the board's refusal on demand to act, *ipso facto,* clears the way for a suit by the demanding stockholder on behalf of the corporation. If it were so, the making of the demand would become a meaningless mechanical operation." 249 F. 2d 858.

In deciding the instant case, however, the Seventh Circuit has ignored those very principles dictated by the decisions of this Court.

B. *Recent Decision of the First Circuit in Conflict with the Seventh Circuit Decision Herein.* The most recent among the many decisions of Courts of Appeal applying the above-cited authorities and analyzing the requirements of Rule 23.1 in a manner contrary to the decision of the Seventh Circuit here is *In Re Kauffman Mutual Fund Actions,* 479 F. 2d 257 (1st Cir. 1973), *cert. denied,* 414 U. S. 857.* In *Kauffman,* the stockholder seeking to maintain derivative litigation on behalf of a number of investment companies against their in-

* In the instant case, the District Court found the *Kauffman* precedent to be directly applicable. *See,* Appendix, page A12. The Seventh Circuit purported to find factual distinctions between *Kauffman* and the instant case. *See,* Appendix, page A24. Whatever the differences in factual context may be, however, it is quite clear from the analysis of the First Circuit in *Kauffman* (quoted in the pages immediately below), that its interpretation of Rule 23.1 is in direct conflict with that of the Seventh Circuit.

vestment advisors and other defendants alleged that demand upon the directors would be "futile." Plaintiff asserted that those directors of the fund who were "affiliated" with the advisors "dominated" and "controlled" the entire board; accordingly, plaintiff alleged, the "self-dealing" of the affiliated directors sterilized the discretion of all, making an objective decision impossible and demand upon the directors a futile act. But, on the basis of "uncontradicted affidavits" showing that a majority of the board had no self-interest in the transaction complained of, the District Court held that plaintiff had not "sufficiently shown the merits of his allegations of futility," and dismissed the complaint forthwith. 479 F. 2d 262-263. This holding the First Circuit affirmed:

> "For lawyers and judges accustomed to the liberalized 'notice' pleading of the Federal Rules . . . a brief review of the background of Rule 23.1 is in order. *Rule 23.1 is not an ordinary, but an exceptional rule of pleading, serving a special purpose, and requiring a different judicial approach* . . . [I]t is normally the directors, not the stockholders, who conduct the affairs of the company. Hence, to be allowed sua sponte, to place himself in charge without first affording the directors the opportunity to occupy their normal status, a stockholder must show that his case is exceptional. *His initial burden is to demonstrate why the directors are incapable of doing their duty, or, as the* [*Supreme*] *Court has put it, to show that 'the antagonism between the directory and the corporate interest be . . . unmistakable.'* " *Id.* at 263. (Emphasis added.)

Thus, the First Circuit confirmed that it is opposition to the corporate interest, not opposition to the stockholder's litigation proposal, which must be shown as a prerequisite to derivative suit. The First Circuit clearly rejected the assertion that mere "resistance" by the Board to the maintenance of suit was synonymous with "futility." That assertion, the First Circuit concluded, is a "classic bootstrap," since good faith resistance by the Board cannot be equated with the necessary bias which establishes "futility." *Id.* at 264.

Turning to the allegation that mere "approval" of or "participation" in the transaction complained of by the directors would excuse demand upon them, the First Circuit stated:

> "Even if we could assume that there had never been a change in the complement of the boards of directors, and that those who were the directors at the time of the suit had approved of the transactions presently attacked, it would not follow that mere prior participation would excuse making the demand. *Where mere approval of the corporate action, absent self-interest or other indication of bias, is the sole basis for establishing the directors' 'wrongdoing' and hence for excusing demand on them, plaintiff's suit should ordinarily be dismissed.* . . . In this respect, the nature of the alleged misconduct must be considered. *Logic suggests a sharp distinction between a transaction completely undirected to a corporate purpose and one which, while perhaps vulnerable to criticism, is of a character that could be thought to serve the interests of the company.* . . . . The conduct alleged in the present case was not, vis-a-vis the individual funds, undirected to a legitimate corporate purpose." *Id.* at 265-266. (Emphasis added.)*

And in explanation of its ruling in favor of the discretion of the directors, the Court observed:

> "We recognize the social desirability of bona fide, well founded minority suits. *We also recognize the tremendous waste involved in suits that are not well founded." Id.* at 267. (Emphasis added.)

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* The First Circuit in *Kaufman* held unequivocally that ". . . to excuse demand in these circumstances—majority of the board approval of an allegedly injurious corporate act—would lead to serious dilution of rule 23.1." 479 F. 2d 265. The First Circuit explained that directors who have "approved" of or "participated" in a transaction which is the subject of the derivative complaint must nonetheless exercise their power and duty to decide upon the wisdom of bringing suit: "When corporate action, or inaction, is subsequently challenged, their duty is not extinguished, but, rather, refocused. After a demand provides them with 'full knowledge of the basis for the claim,' . . . it is for the directors, who have 'the advantage of familiarity with the enterprise, with those who have conducted it and with the record of success or failure' to decide on the appropriate corporate response." 479 F. 2d 266-267.

The rule of law prescribed by this Court in the cases reviewed above, and by the Court of Appeals for the First Circuit in *In Re Kaufman Mutual Fund Actions*, 479 F. 2d 257, was applied in straightforward fashion by the District Court in this case.* The Seventh Circuit, in declining to follow the teaching of those authorities, and in holding that mere opposition by the board to the proposed litigation warrants extraordinary equitable intervention, has adopted an interpretation of Rule 23.1 which conflicts with that of this Court and the First Circuit, and indeed conflicts directly with instructions upon the very same subject heretofore given to the Seventh Circuit by this Court in *Swanson* v. *Traer*, 354 U. S. 114, quoted on page 14 above.

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* In the instant case, the District Court determined, as a matter of law, that the stockholder had failed to allege any ground for concluding that the Leasco directors were biased or incapable of exercising business judgment—precisely the determination which the decisions of this Court require. *See*, Appendix, pages A8-A9, A13-A14. The District Court rejected, as a matter of law, the speculation of the stockholder that the Leasco directors might be biased as a result of their supposed fear of "personal liability" as "aiders and abettors" of the alleged illegal loan to Leasco. The District Court noted that the stockholder had specifically instructed that the directors not be served with process, thus foreclosing any exposure to liability, and that, in any event, there was no basis for the "personal liability" speculation because the margin regulations here involved simply did not apply to their conduct. In 1968, the margin regulations attached sanctions *only* to the conduct of creditors, not borrowers and their officers. "[I]t is not illegal for a customer to buy on credit illegally extended." Loss, *Securities Regulation*, Vol. V. (1969), page 3304. The judicial authorities to that effect are legion, and virtually uncontradicted. However, because the Seventh Circuit attached "no significance" to arguments about "aider and abettor" liability, there is no need to belabor the point here. *See*, Appendix, page A23.

II. The Proper Interpretation of the Demand Requirement of Rule 23.1 Is a Matter of Extreme Importance to the Administration of Derivative Litigation in the Federal Judicial System. The Practical Consequence of the Decision of the Court Below Is That Individual Stockholders Will have the Power to Dictate the Litigation Policies of Major Corporations Throughout the Seventh Circuit, and Will Be Able to Press Unfounded Claims or Claims Detrimental to the Corporate Interest at Great Expense to the Parties and with Consequent Waste of the Resources of the Federal Courts.

The Seventh Circuit found it sufficient to sustain the instant derivative complaint "that under no circumstances would the board of directors have approved the corporation bringing the action." *See,* Appendix, page A24. That very fact, however, should be a message "loud and clear" that the situation requires special scrutiny by the District Court; that the directors elected to manage a publicly held corporation have determined that the litigation proposed by a single stockholder would be injurious to the company; and that the stockholder should be put to the test of alleging specific facts showing the directors to be incompetent to exercise business judgment. The decision of the Seventh Circuit stands the traditional rule of "prior demand" upon its head: in situations calling with utmost urgency for consideration by the District Court of the position of the board—situations where the board finds the litigation actually injurious to the company—the opposition of the board would be converted into an excuse to ignore the board and to plunge ahead with litigation injurious to the corporation.

In accepting the argument that "opposition" is sufficient to excuse demand, the Seventh Circuit reasoned that Rule 23.1 requires nothing more than an explanation why demand was not made. Any other interpretation, the Seventh Circuit reasoned, would render "meaningless" the "alternative prong of rule

23.1" which permits the stockholder to "explain" why the board was by-passed. Appendix, page A23. However, it is not *any* explanation or excuse which suffices. The stockholder must allege with specificity why the board is incapable of doing its duty, and why it is aligned in interest against the corporation. "The present rule [a predecessor of Rule 23.1] . . . adds . . . the words, —'or the reasons for not making such effort'; *and these reasons, of course, must be adequate.*" *Wathen* v. *Jackson Oil Co.*, 235 U. S. 635, 640 (1915). (Emphasis supplied.)

It is apparent that the practical effect of the Seventh Circuit's decision here is that individual stockholder plaintiffs (or their lawyers) will be able to override the good faith judgment of the legal advisors and boards of directors of corporations in the Seventh Circuit. It is also clear that the more groundless and vexatious a derivative complaint may be, the more likely it is that the stockholder will be able to satisfy the test of standing to sue incorrectly prescribed by the Seventh Circuit here—*viz.*, that the stockholder will be able to assert that management is "opposed" to the litigation. And, if the transaction which the stockholder seeks to controvert is a substantial one, the stockholder will always be able to add the assertion that some of the directors had "participated" in the transaction.

The Seventh Circuit's erosion of the rule of standing to sue which is traditional in derivative litigation is especially unjustifiable where, as here, the management of the corporation resists the litigation not only because it would injure the company, but also because it regards the litigation to be based upon a distortion of the facts and to be inconsistent with the dictates of honesty and good business ethics. To avoid this abuse of the litigation process, the decisions of this Court (examined on pages 11-15 above) have uniformly approved use of the dismissal motion *in limine* to test the standing of the would-be derivative plaintiff.

It is no answer to maintain, as has the Seventh Circuit here, that the opposition of the directors may somehow be weighed in

connection with defendant's case on the merits at some later stage of the litigation. The views of the Leasco directors have been stripped by the Seventh Circuit of any functional significance. The decision of the directors *not* to commence suit is, in the view of the Seventh Circuit, merely an ingredient to be considered in litigating the case on the merits (or an opinion to be compared with the District Court's own ultimate assessment of the merits after that assessment is a *fait accompli*): "This decision and determination [by the directors] may well be proved to have been a sound evaluation when the merits questions are reached in this litigation . . ." Appendix, page A24. Just how the District Court would give effect to *that* conclusion at a hearing on the merits is not explained by the Seventh Circuit. Indeed, by that time many of the reasons why the directors originally opposed the litigation may well have become moot, for by then the case will have proceeded through discovery, depositions, and other expensive and time-consuming pre-trial proceedings disruptive of normal business activities, and (given the reluctance of the district courts to dispose of the "merits" of corporate lawsuits by summary judgment) may have proceeded through a lengthy trial as well. Thus, contrary to the teaching of the decisions of this Court and the First Circuit, the Seventh Circuit would allow the stockholder to "try the case on the merits" in an attempt "to show that he had a right to bring it." *In re Kauffman Mutual Fund Actions*, 479 F. 2d at 265. That approach to standing under Rule 23.1 would, in the words of the District Court below, "strip Rule 23.1 of any logical meaning." *See* Appendix, page A8.

Moreover, postponing determination of the question whether the stockholder has alleged facts indicating the inability of the directors to do their duty until pretrial proceedings and a trial on the merits have been completed will *encourage* stockholders and their attorneys to capitalize upon the nuisance value of derivative complaints, wasting both private and judicial resources. *See, In re Kauffman Mutual Fund Actions*, 479 F. 2d

257, 267 (1st Cir. 1973), *cert. denied.*, 414 U. S. 857, emphasizing the ". . . tremendous waste involved in [derivative] suits which are not well founded." *See also, Blue Chip Stamps* v. *Manor Drug Stores*, 421 U. S. 723, 742-743 (1975), noting that rules of standing (there, a securities case) should not be eroded in situations ". . . where the mere existence of an unresolved lawsuit has settlement value to the plaintiff not only because of the possibility that he may prevail on the merits, an entirely legitimate component of settlement value, but because of the threat of extensive discovery and disruption of normal business activities which may accompany a lawsuit which is groundless in any event, but cannot be proved so before trial . . . ."

The decision of the Seventh Circuit deprives business corporations of the protection from harassment and injury which it was the very purpose of Rule 23.1 to extend to them. In reliance upon the Seventh Circuit decision here, counsel for individual stockholders may make business corporations their involuntary clients and embroil them in protracted legal quarrels simply by alleging that the directors are opposed to the theories and proposals of counsel. As John Dawson, Fairchild Professor of Law Emeritus at Harvard Law School, has noted: "In recent times, the richest gold mine produced for lawyers . . . has been the stockholder derivative suit." And as Professor Dawson also comments, the financial incentive involved is equally alluring in the case of groundless as in meritorious derivative actions, for even the groundless action has substantial settlement value: "A settlement or compliance that is sufficient to moot the case may represent mere submission in order to escape the disruption and cost of resistance to a false claim." Dawson, *Lawyers and Involuntary Clients in Public Interest Litigation*, 88 *Harv. L. Rev.* 849, 854, 859 (1975).* With the temptation to abuse of deriva-

* In *Dimpfell* v. *Ohio and Mississippi R. Co.*, 110 U. S. 209, 210 (1884), this Court minced no words in addressing the same point, noting that stockholders may file derivative suits to "annoy and vex the company," and to "extort" a settlement. "Unfortunately, litigation against large companies is often instituted by individual stockholders from no higher motive."

tive actions existing on such a scale, it is of prime importance that this Court reaffirm the requirements of Rule 23.1, which have served historically to prevent the waste of public and private resources inherent in unfounded stockholder litigation.

CONCLUSION.

For the reasons stated above, this Court should grant the instant petition for certiorari to resolve the conflict between the decision of the Seventh Circuit and the prior decisions of this Court, as well as between the decision of the Seventh Circuit and the recent decision of the First Circuit.

Respectfully submitted,

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Dated: December 1, 1975.

APPENDIX.

UNITED STATES DISTRICT COURT
For the Northern District of Illinois
Eastern Division

MOLLIE NUSSBACHER,
Plaintiff,
vs.
CONTINENTAL ILLINOIS NATIONAL BANK AND TRUST COMPANY OF CHICAGO, et al.,
Defendants.

No. 73 C 512

STATE OF NEW YORK
COUNTY OF NEW YORK } ss.

AFFIDAVIT

Saul P. Steinberg, being duly sworn, deposes and says:

1. I am and at all times mentioned herein have been the Chairman of the Board of Directors of Leasco Corporation (formerly Leasco Data Processing Equipment Corporation) ("Leasco").

2. In the first quarter of 1968 Leasco's Board of Directors began to consider the acquisition of a major insurance company. It was the Board's opinion that such an acquisition, if consummated, would make Leasco a larger, more diversified and profitable enterprise, with commensurate benefits for Leasco's stockholders.

3. At this time Leasco's attention was called to the Reliance Insurance Company ("Reliance"). Reliance had everything we

wanted—size, substantial earnings and long-term stability. Accordingly, Leasco subsequently made a registered offer to the shareholders of Reliance to acquire their shares in Reliance in exchange for convertible preferred stock of Leasco and warrants to purchase Leasco common stock.

4. It became evident very early that Leasco's exchange offer for Reliance would stand a greater chance of success if firm arrangements could be made to acquire the Reliance Class A shares, which at the time constituted approximately 14% of the issued and outstanding shares of Reliance.

5. As a result of the foregoing, Leasco entered into the transactions complained of by the plaintiff and was enabled to acquire the Reliance Class A common stock and, ultimately, Reliance itself.

6. No director of Leasco, past or present, had any interest, direct or indirect, in the Reliance Class A transaction or any part of it. The directors of Leasco took the action they did with respect to such transaction solely because they believed their actions were in Leasco's best interest.

7. Leasco's decision to acquire Reliance has been demonstrated to have been a significant step forward and very beneficial to Leasco and its stockholders. Leasco, since acquiring Reliance, has grown significantly and has prospered. It would be a gross distortion of the facts to contend that the acquisition in any way harmed the corporation, or diminished its profitability. Quite the opposite is the case.

8. As I now understand the substance of the complaint in this action, it is that the Reliance Class A transaction was not a purchase of the Leasco stock by the defendants herein but, on the contrary, was a loan to Leasco and, as such, a violation of Regulation U of the Federal Reserve Board. I am not a lawyer and do not know whether there is legal substance to this contention. I do know, however, that it never occurred to me or to my knowledge to anybody else with whom I discussed these matters that Leasco was, in effect, borrowing money. If we had

believed this was borrowed money, Leasco would have taken appropriate deductions on its tax returns, which it did not. More importantly, Leasco participated in the transaction which is the subject of this action upon the understanding that it was no more than what it appeared to be, namely an exchange and purchase of securities. It was not a disguised loan; Leasco had no need to borrow funds to acquire the Reliance shares. Its function was to permit Leasco to obtain Reliance shares through an exchange for its securities and thus obtain the full benefits of "pooling of interests" accounting.

9. If the Plaintiff or her counsel had proposed that Leasco commence this action, as a matter of business judgment, their proposal would have been rejected for the same reasons that Leasco itself would not have initiated this case. To do so would have been inconsistent with our understanding of the facts and damaging to the business interests of the Company and its shareholders.

The Reliance acquisition is the cornerstone of Leasco's present business position. The financial institutions who have been made defendants in this case assisted Leasco in good faith in accomplishing a key element of that acquisition by purchasing the Leasco units from the Class A sellers. In equal good faith, Leasco entered into these transactions and undertook, and eventually satisfied, certain obligations to those institutions. In my view, it would be against the long-term interest of Leasco to attempt to renege on its obligations to those institutions on the basis of what seems, to me as a layman, to be a legalistic technicality.

We participated in the transaction which is the subject of this case upon the understanding, which we still hold, that it was exactly what it appeared to be, that is to say, an exchange and purchase of securities. There was full disclosure to the public and the Securities and Exchange Commission, and we had no notion whatsoever that it would have been characterized as an evasion of any law.

In my view, the long-term interest of our shareholders will be best served by our maintaining a position of inflexible integrity and a fair dealing in our relations with the financial community; I would have considered it wholly inconsistent with this position for my Company to have participated in this attempt to collect some money from the defendants on the grounds pressed by the Plaintiff.

10. I have discussed this matter with the other directors of Leasco and I assure this Court that they are in agreement with the views expressed herein. My decision in this respect, and that of my fellow Directors, is based on our unbiased concern for the best interests of the corporation. No personal hope of gain or fear of loss or liability has occasioned the decision to disapprove the present derivative suit.

11. The attached exhibit is an excerpt from the minutes of the April 19, 1972 meeting of the Board of Directors of Leasco Corporation, duly dated and certified. The document is certified as a true and accurate copy of those minutes and I affirm that it has been certified by the Secretary of Leasco Corporation, as specifically stated thereon. This exhibit demonstrates the determination of the Board of Directors of Leasco Corporation that the present derivative suit maintained by Plaintiff Nussbacher is inconsistent with the best interests of the Corporation.

/s/ SAUL P. STEINBERG,
Saul P. Steinberg.

Sworn to before me this 27th day of April, 1973.

/s/ KRIS K. KUNSTADTER,
Notary Public.

CERTIFICATE

I, MICHAEL D. BARTELL, Assistant Secretary of Leasco Corporation, a Delaware corporation (herein called the "Company"), do hereby certify that annexed hereto as Exhibit A is a true and correct copy of an extract from the Minutes of the meeting of the Board of Directors of the Company held on April 18, 1972, as recorded in the Minute Book of the Company, and that the aforesaid extract has not been revoked or amended.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed the seal of Leasco Corporation this 23rd day of April, 1973.

/s/ MICHAEL D. BARTELL,
Michael D. Bartell,
Assistant Secretary.

EXHIBIT A

The Chairman next gave the Board a status report on the Nussbacher litigation. He said that the Corporation recognized that courts have been quite lenient in permitting shareholders to sue derivatively to seek recovery on behalf of the Corporation even though the Corporation believed, as it did in this case, that the action was contrary to business ethics and that for the Corporation to have initiated such action would have been damaging to its credit and standing in the financial community. He stated that at the time of the Class A transaction, neither he, nor to his knowledge anyone connected with the transaction, considered it to be a loan. He stated that if this Corporation had believed it was borrowing money, it would have taken appropriate deductions on its tax returns, which it did not. He stated that, in his view, it would be against the long-term interests of this Corporation to attempt to take advanage of what seems to him to be a legal technicality. He said that the officers and directors of the Corporation would provide affidavits to defendants' counsel being governed in regard to such affidavits solely by the truth of the factual statements therein. Thereupon, upon full discussion, the Board of Directors of this Corporation stated that they were unanimously in agreement with the statements made by the Chairman.

UNITED STATES DISTRICT COURT,
N. D. Illinois, E. D.
July 16, 1973.

MOLLIE NUSSBACHER,
Plaintiff,
vs.
CONTINENTAL ILLINOIS BANK AND TRUST COMPANY OF CHICAGO ET AL.,
Defendants.

No. 73 C 512.

MEMORANDUM OPINION and JUDGMENT ORDER.

AUSTIN, *District Judge.*

Plaintiff, a shareholder in Leasco Corporation, commenced this derivative action on its behalf against Continental Bank and Trust Company of Chicago and the Leasco directors. Plaintiff seeks to recover for Leasco damages sustained as a result of defendants' violations of the Securities Exchange Act of 1934 and the credit margin requirements of the Federal Reserve Board. The principal claim presented asserts that certain lending institutions, the most prominent of which was defendant Continental, unlawfully extended credit to enable Leasco to accomplish a takeover of Reliance Insurance Company. For a detailed factual treatment of the Leasco-Reliance takeover and some of the federal violations resulting therefrom, see Judge Weinstein's decision in *Feit* v. *Leasco*, 332 F. Supp. 544 (E. D. N. Y. 1971). Such a presentation is unnecessary in the resolution of the instant matter.

Defendant Continental moves to dismiss the complaint on the grounds that plaintiff failed to verify it and to allege, with

particularity, reasons excusing the making of a prior demand upon Leasco's directors. Continental further contends that the alleged defects are fatal and require dismissal. For reasons stated below, defendant's motion to dismiss is granted with leave to amend. Both issues are treated in this opinion in the event that plaintiff is able to cure her complaint upon amendment.

I. Verification of the Derivative Complaint.

Fed. R. Civ. P. 23.1 specifies that the complaint in a derivative action must be verified. Prior to instituting this claim, plaintiff commenced a similar suit in the United States District Court for the Southern District of New York. Although that action was dismissed for lack of proper venue, the complaint submitted therein was verified and nothing presented to this court leads me to believe that the failure to verify here was anything other than an inadvertent mistake. Indeed, plaintiff has now proffered verification and has submitted an affidavit demonstrating her good faith in this regard. The best authorities maintain that failure to verify is a technical defect, curable by amendment. 2 Moore, *Federal Practice* ¶ 3.04 2d Ed. (1970); 7A, C. Wright & A. Miller, *Federal Practice and Procedure* § 1827 (1972); *cf. Surowitz* v. *Hilton Hotels Corp.*, 383 U. S. 363, 86 S. Ct. 845, 15 L. Ed. 2d 807 (1966). And I so hold.

II. Demand on Directors.

Again turning to Rule 23.1, a proper derivative suit must "allege with particularity the efforts, if any, made by the plaintiff to obtain the action he desires from the directors . . . and the reasons for his failure to obtain the action or for not making the effort." Plaintiff's excuse for not making demand is that the directors are defendants herein, had knowledge of and acquiesced in the wrongs set forth in the complaint, and are jointly and severally liable for the damages caused to Leasco.

Defendant responds that none of the directors have been personally served, that all director decisions pertinent to this action are protected from the shareholder attack by the business judgment rule, and that the directors cannot be liable under the credit margin requirements since, at the time these transactions occurred, such rules were applicable only to lender institutions. I find this line of argument highly persuasive.

The rationale of the Rule 23.1 demand requirement is that the corporate board of directors, exercising their reasonable and good faith business judgment, possesses the paramount right to corporate control and management. *Cohen* v. *Beneficial Indus. Loan Corp.*, 337 U. S. 541, 69 S. Ct. 1221, 93 L. Ed. 1528 (1949). The power and right to invoke judicial sanctions to rectify corporate injuries resides in the board of directors and represents an integral aspect of their duties.

While excuse of demand is wholly within the sound discretion of the trial court, *Robison* v. *Caster*, 356 F. 2d 924 (7th Cir. 1966), it is usually limited to cases where the directors wrongfully refuse to pursue corporate rights or are personally involved in the wrongdoing. Fletcher, Corporate Cyclopedia, § 5965, n. 2 (1970), Note, 73 *Harv. L. Rev.* 746, 753 (1960) (citing cases). Indeed, mere approval of corporate action, absent self-interest or bias, cannot be the basis for establishing director misconduct since directors are afforded such considerable latitude in managing their corporations. *In re Kauffman Mutual Fund Actions*, 479 F. 2d 257. (1st Cir. 1973.) To hold otherwise would be to strip Rule 23.1 of any logical meaning.

Thus, before a court will dislodge control from its rightful possessors, the complaining shareholder must show that his complaint is an exceptional one. This burden rests squarely with the plaintiff and may be raised by any party to the action. See, *e.g.*, *Hawes* v. *Oakland*, 104 U. S. 450, 26 L. Ed 827 (1881) (lack of demand raised by city of Oakland), and *Robison* v. *Caster*, *supra*, (issue raised by individual defendant's executor). The shareholder must, in short, either diligently exhaust his

internal corporate remedies or "allege with particularity" the reasons why such exhaustion would be meaningless.

Plaintiff's broad, conclusory allegations of wrongdoing by the directors are unsupported by underlying facts and, indeed, are contradicted by the fact that the directors, as members of a borrowing corporation, could not be liable under the credit margin rules, even if a violation was proven. Plaintiff's complaint alleges no other "wrongdoing," nor can such conclusions be fairly drawn from plaintiff's documents.

In this context, I cannot find that demand upon the directors would be futile or useless. If plaintiff is correct in her conclusory allegations of director liability and hostility, such facts must be properly alleged and verified. No such facts are so alleged and verified. Accordingly, defendant's motion to dismiss is granted with leave of 20 days to amend plaintiffs' complaint in accordance with this decision.

Plaintiff's contentions concerning the law of the case doctrine have been considered and are resolved against her. *See* Moore, *Federal Practice*, ¶ 0.404 (2d ed. 1970).

So ordered.

UNITED STATES DISTRICT COURT,
N. D. Illinois, E. D.,
December 18, 1973.

MOLLIE NUSSBACHER,
Plaintiff,

vs.

CONTINENTAL ILLINOIS BANK AND TRUST COMPANY OF CHICAGO ET AL.,
Defendants.

No. 73 C 512.

SUPPLEMENTAL OPINION.

AUSTIN, *District Judge.*

In attempted compliance with my Memorandum Opinion and Judgment Order of July 16, 1973, plaintiff filed her verified amended complaint on September 7, 1973. Therefore, she has cured the first defect in her original complaint, namely, her failure to verify it. However, defendant Continental Bank now moves to dismiss again because of plaintiff's failure to comply with the requirement under Fed. R. Civ. P. 23.1 that formal demand be made upon the Leasco board of directors to enforce the alleged right of the corporation or that there be a showing of an adequate excuse for failure to make such a demand.

The subject, then, of this supplemental opinion is resolution of the question whether plaintiff's amended complaint meets the demand requirements of Fed. R. Civ. P. 23.1. The allegations of both the original complaint and the amended complaint which are pertinent to the instant matter are set forth in the margin.[1]

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1. The allegations of the original complaint are as follows:

26. The individual defendants who are the directors of Leasco participated, approved and acquiesced in the wrongful

Each of these allegations shall be considered in concluding that defendant's motion to dismiss must be granted with prejudice.

At the outset, it should be noted that the principles enunciated in my July 16, 1973 opinion are the law of this case;

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transactions hereinbefore set forth. They are liable, jointly and severally, to Leasco for the losses sustained by it.

27. Demand upon the directors to bring this action would be futile because:

(a) The directors are defendants herein and are jointly and severally liable for the damages caused to Leasco.

(b) The directors had knowledge of and acquiesced in the wrongs set forth in this complaint. In view of the fact that they have approved of the wrongdoings, it is unreasonable to expect them to reverse their former position and assert this action on behalf of Leasco.

(c) The board had knowledge of the wrongs set forth in this complaint for a long period of time and has failed to take any action to remedy the situation.

28. * * * *

(c) Even if the shareholders were to direct the board of directors to bring this action, its control would lie in the hostile hands of the directors, who could not be entrusted with its effective prosecution.

The allegations of the amended complaint are as follows:

32. Plaintiff has not made demand upon Leasco's directors to commence the within action since, for the following reasons, she believes such demand to be a futile and useless act.

A. (i) After commencing an identical action in the United States District Court for the Southern District of New York, representatives of plaintiffs initiated a discussion with representatives of Leasco to determine whether Leasco would assist plaintiff directly or indirectly in the prosecution of that action. Plaintiff was informed that Leasco's representatives refused to assist plaintiff in any way.

(ii) On May 10, 1971, Leasco informed the Arrangers and Lenders that it had been advised by counsel that "it must adopt a neutral stance with regard to the lawsuit."

(iii) Leasco's Board of Directors met on April 18, 1972 and discussed the New York action brought by plaintiff. At that meeting, the Board decided that it would be "contrary to business ethics" and the corporation's interest for Leasco to have initiated such action.

(iv) In view of the expressed attitude of Leasco's Directors in an identical action commenced by plaintiff in which the

and, therefore, they shall be adhered to in considering defendant's motion to dismiss. In particular, the principles adopted from the case of *In re Kauffman Mutual Fund Actions*, 479 F. 2d 257 (1st Cir. 1973), *cert. denied*, 414 U. S. 857, 94 S. Ct. 161, 38 L. Ed. 2d 107 (1973) control the outcome of the pending motion.

A. *Refusal of the board to assist plaintiff in a previous identical action in which she had failed to formally demand that it enforce the rights of the corporation is not a sufficient excuse for her failure to so demand in the instant suit.*

In sentence 32-A(i) of the amended complaint, plaintiff alleges and contends she is not required to demand that the board enforce the rights of Leasco because it already refused to assist her in a previous identical action filed in the United States District of New York. However, she goes on to admit, in effect, that she did not make a formal demand of the board, but rather, had merely "initiated a discussion with representatives of Leasco to determine whether Leasco would assist" her in the prosecution of that action. Thus, plaintiff appears to be of the view that the prior refusal of the board to assist her, despite the absence of a formal demand for such action,

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defendant Continental was a defendant for a portion of the time, plaintiff does not believe that Leasco's Directors would adopt a different attitude were demand to have been made by her upon them prior to the commencement of this action.

B. The Leasco Directors, constituting a majority of its present Board, participated in and aided and abetted the Arrangers and Lenders in the illegal credit plan. They are personally liable for damages sustained by Leasco. Being personally involved in the wrongdoing, they cannot reasonably be expected to enforce Leasco's rights.

C. Because of their personal involvement, the Leasco Directors are seeking to vindicate their actions and are prevented from an unprejudicial consideration of the merits of this action.

D. Because of the close relationship between the Leasco Directors and the Arrangers and Lenders, they are further prevented from an unprejudicial consideration of the merits of this action.

is a sufficient excuse for her failure to make such a demand in the present case.

Plaintiff's position is an untenable attempt to bootstrap herself over the hurdles placed in her path by Fed. R. Civ. P. 23.1. *See, In re Kauffman Mutual Fund Actions,* 479 F. 2d 257, 264 (1st Cir. 1973), *cert. denied* 414 U. S. 857, 94 S. Ct. 161, 38 L. Ed. 2d 107 (1973). In the absence of formal demand that it enforce the right of the corporation, mere refusal of the board of directors to assist a shareholder in her first derivative suit—or even the board's opposition to said suit—is not an adequate excuse for failure to comply with the demand requirements of Fed. R. Civ. P. 23.1 in a subsequent separate suit to recover on the original cause of action. Accordingly, the above allegations are insufficient to excuse formal demand that the board of directors seek to recover on the cause of action alleged in the complaint.

Sentences 32-A(ii), (iii) and (iv) of the amended complaint are also insufficient, since they merely allege that the Board "had been advised by counsel that 'it must adopt a neutral stance with regard to the lawsuit,' " and that the board "decided that it would be 'contrary to business ethics' and the corporation's interest for Leasco to have initiated such action." Such allegations in no way demonstrate that making a formal demand upon the board would be a useless or futile gesture, and therefore, they do not present an adequate excuse for failure to comply with Fed. R. Civ. P. 23.1.

B. *General and conclusory allegations of aiding and abetting, and participating in, illegal activity which allegedly injured the corporation is not a showing of self-interest or bias in the board against enforcing the rights of the corporation which would be sufficient to excuse the demand requirements of Fed. R. Civ. P. 23.1.*

In my previous opinion, I observed that "mere approval of corporate action, absent self-interest or bias, cannot be the

basis for establishing director misconduct" sufficient to excuse a shareholder from having to formally demand that the board enforce an alleged right of the corporation.[2] Furthermore, I held that broad and conclusory allegations of wrongdoing by the directors which are unsupported by underlying facts are not adequate to excuse the requirements of Rule 23.1.[3]

Plaintiff has failed to repair the defects in her original complaint. She presently alleges in subparagraph 32-B that the Leasco Board participated, and aided and abetted, in the alleged illegal loan in this case, that, as a result, they are personally liable to the corporation, and that therefore they are sufficiently biased so as to excuse the requirement of Rule 23.1. This is clearly not enough, since, in the first place, the directors are *not* personally liable under the law as it existed at the time of the loan in question;[4] and, in the second place, the remaining allegations merely state the directors, in their official capacity, "participated in and aided and abetted" in the illegal loan. Thus plaintiff fails to allege any underlying facts indicating self-interest or bias in the board of directors which would excuse demand that it take on the suit; and the same is true of subparagraphs 32-C and D of the amended complaint. They all utterly fail to allege specific, underlying facts indicating any self-interest or bias in the directors which would justify wresting from them their power and right to determine whether to enforce a right of the corporation. Plaintiff therefore fails to meet the demand requirements of Fed. R. Civ. P. 23.1, and therefore defendant's motion to dismiss must be granted with prejudice.

Such dismissal shall, of course, have no *res judicata* effect as far as the *merits* of the case are concerned. Rather, it affects only the issue of demand or excuse thereof under Rule 23.1.

So ordered.

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2. See my opinion of July 16, 1973 p. 402.
3. See my opinion of July 16, 1973 p. 402.
4. See my opinion of July 16, 1973 p. 402.

IN THE UNITED STATES COURT OF APPEALS
For the Seventh Circuit

No. 74-1142

MOLLIE NUSSBACHER,
Plaintiff-Appellant,

vs.

CONTINENTAL ILLINOIS NATIONAL BANK AND TRUST COMPANY OF CHICAGO, ET AL.
Defendants-Appellees.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF ILLINOIS, EASTERN DIVISION

No. 73 C 512

RICHARD B. AUSTIN, *Judge.*

Argued November 21, 1974—Decided July 15, 1975

Before FAIRCHILD, *Chief Judge,* PELL, *Circuit Judge,* and WYZANSKI, *Senior District Judge.**

PELL, *Circuit Judge.* This is an appeal from a final judgment order dismissing the amended derivative complaint of Mollie Nussbacher, a stockholder of Leasco Corporation. Defendants named were the Continental Illinois National Bank and Trust Company of Chicago, appellant herein, Leasco Corporation and the nine members of Leasco's board of directors.

* Senior District Judge Charles Edward Wyzanski, Jr. of the United States District Court for the District of Massachusetts is sitting by designation.

Pursuant to directions of the plaintiff no attempt was made to serve the individual defendants with process. Finding that Nussbacher had not made an appropriate demand upon the board of directors of Leasco under Rule 23.1, Fed. R. Civ. P.,[1] the district court held that Nussbacher was precluded from bringing the derivative suit. *Nussbacher* v. *Continental Illinois Bank and Trust Company*, 61 F. R. D. 399 (N. D. Ill. 1973). This appeal followed.

This litigation arose from the acquisition by Leasco of another corporation, Reliance Insurance Company, which allegedly did not desire to be acquired. The allegations of the complaint[2] were that to accomplish its goal it was necessary for Leasco to acquire certain controlling stock of Reliance; that to do so it was necessary to resort to cash purchases rather than the exchange offer originally offered; that Leasco's investment bankers devised a plan whereby Reliance's shareholders would exchange their stock for that of Leasco and simultaneously certain lenders, including Continental, would furnish the money which would be given to the Reliance shareholders in exchange for their stock which would be held by the lenders as security for Leasco's guarantee to repay the money advanced by the lenders.[3]

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1. Rule 23.1 states in pertinent part:
"In a derivative action brought by one or more shareholders or members to enforce a right of a corporation or of an unincorporated association, the corporation or association having failed to enforce a right which may be properly asserted by it, the complaint shall be verified and shall allege . . . with particularity the efforts, if any, made by the plaintiff to obtain the action he desires from the directors or comparable authority and, if necessary, from the shareholders or members, and the reasons for his failure to obtain the action or for not making the effort."

2. The original complaint had also been dismissed for two reasons under Rule 23.1, lack of verification and lack of demand. For our present purposes we are referring to the amended complaint which was subsequently filed as the "complaint" since it was from the dismissal of the amended complaint that this appeal was taken.

3. Continental characterizes the transaction as a purchase of the Leasco shares in which the purchasers, including Continental, had several options: (1) arranging for a secondary offering of the

The gist of the complaint is that the Leasco securities were in actuality collateral for loans; that as loans they failed to meet applicable provisions of margin regulations;[4] that Leasco paid interest of 15% to the lenders, a rate in excess of that which would have been payable if the loans had been properly collateralized; that the market value of the Leasco securities declined sharply and when redeemed they had a market value substantially below that at the time of the original loan.[5]

In 1972, Nussbacher had commenced an action basically identical to the one here under review in a federal district court in New York against the defendant Continental, the arrangers of the Reliance transaction, and other so-called lenders. Continental secured its dismissal from this action because of lack of venue. It was also alleged that the board of directors consisted of 7 members in July 1968 and that the 6 individual defendants are still directors and constitute a majority of the board. It was further charged that the directors aided and abetted the arrangers and lenders in the allegedly illegal credit plan and in soliciting lenders.

Now coming to that which is crucial to the present appeal, the complaint alleged that plaintiff had not made demand upon Leasco's directors to commence the action for the following reasons, she believing that demand would be a futile and useless act:

Leasco securities, (2) reselling the securities to Leasco, or (3) as outright purchasers retaining the securities in their own investment portfolios. Because of the disposition we reach on this appeal, it is not necessary at this time to decide whether the substance of the transactions equated with the form thereof.

4. The credit regulations of the Federal Reserve Board limit the amount of credit which a bank may extend to a borrower, where the borrower plans to use the credit to invest in certain classes of securities, and where the underlying debt is secured by stock. See Regulation U, 12 C. F. R. 221. A comparable regulation issued by the Federal Reserve Board (Regulation T) limits credit extended by brokers.

5. For an exhaustive discussion of the Leasco-Reliance transactions, see *Feit* v. *Leasco Data Processing Equipment Corporation,* 332 F. Supp. 544 (E. D. N. Y. 1971).

"A. (i) After commencing an identical action in the United States District Court for the Southern District of New York, representatives of plaintiffs initiated a discussion with representatives of Leasco to determine whether Leasco would assist plaintiff directly or indirectly in the prosecution of that action. Plaintiff was informed that Leasco's representatives refused to assist plaintiff in any way.

(ii) On May 10, 1971, Leasco informed the Arrangers and Lenders that it had been advised by counsel that 'it must adopt a neutral stance with regard to the lawsuit.'

(iii) Leasco's Board of Directors met on April 18, 1972 and discussed the New York action brought by plaintiff. At that meeting, the Board decided that it would be 'contrary to business ethics' and the corporation's interest for Leasco to have initiated such action.

(iv) In view of the expressed attitude of Leasco's Directors in an identical action commenced by plaintiff in which the defendant Continental was a defendant for a portion of the time, plaintiff does not believe that Leasco's Directors would adopt a different attitude were demand to have been made by her upon them prior to the commencement of this action."

"B. The Leasco Directors, constituting a majority of its present Board, participated in and aided and abetted the Arrangers and Lenders in the illegal credit plan. They are personally liable for damages sustained by Leasco. Being personally involved in the wrongdoing, they cannot reasonably be expected to enforce Leasco's rights."

"C. Because of their personal involvement, the Leasco Directors are seeking to vindicate their actions and are prevented from an unprejudicial consideration of the merits of this action."

"D. Because of the close relationship between the Leasco Directors and the Arrangers and Lenders, they are further prevented from an unprejudicial consideration of the merits of this action."

The minutes of the meeting of the board of directors referred to in the complaint contained the following:

"The Chairman next gave the Board a status report on the Nussbacher litigation. He said that the Corporation recognized that courts have been quite lenient in permitting shareholders to sue derivatively to seek recovery on behalf of the Corporation even though the Corporation believed, as it did in this case, that the action was contrary to business ethics and that for the Corporation to have initiated such action would have been damaging to its credit and standing in the financial community. He stated that at the time of the Class A transaction, neither he, nor to his knowledge anyone connected with the transaction, considered it to be a loan. He stated that if this Corporation had believed it was borrowing money, it would have taken appropriate deductions on its tax returns, which it did not. He stated that, in this view, it would be against the long-term interests of this Corporation to attempt to take advantage of what seems to him to be a legal technicality. He said that the officers and directors of the Corporation would provide affidavits to defendants' counsel being governed in regard to such affidavits solely by the truth of the factual statements therein. Thereupon, upon full discussion, the Board of Directors of this Corporation stated that they were unanimously in agreement with the statement made by the Chairman."

In support of its motion to dismiss directed against the original complaint, Continental filed the affidavit of Saul P. Steinberg, at all material times chairman of the board of Leasco. The affidavit dwelt upon the good faith of the board members, the basis for belief that the Reliance transactions were accomplished legally and that they were what they purported to be, an exchange and purchase arrangement, that it never occurred to the affiant or to his knowledge anybody else that Leasco was in effect borrowing money, and that since the acquisition, Leasco had grown and prospered. The affidavit also contained the following:

"If the Plaintiff or her counsel had proposed that Leasco commence this action, as a matter of business judgment, their proposal would have been rejected for the same reasons that Leasco itself would not have initiated this case.

To do so would have been inconsistent with our understanding of the facts and damaging to the business interests of the Company and its shareholders."

* * * * *

"In my view, the long-term interest of our shareholders will be best served by our maintaining a position of inflexible integrity and a fair dealing in our relations with the financial community; I would have considered it wholly inconsistent with this position for my Company to have participated in this attempt to collect some money from the defendants on the grounds pressed by the plaintiff."

"I have discussed this matter with the other directors of Leasco and I assure this Court that they are in agreement with the views expressed herein. My decision in this respect, and that of my fellow Directors, is based on our unbiased concern for the best interests of the corporation. No personal hope of gain or fear of loss or liability has occasioned the decision to disapprove the *present* derivative suit." [Emphasis added].

* * * * *

"This exhibit [excerpt of the board minutes quoted heretofore in this opinion] demonstrates the determination of the Board of Directors of Leasco Corporation that the present derivative suit maintained by Plaintiff Nussbacher is inconsistent with the best interests of the Corporation."

At least from the time of the landmark decision in *Hawes* v. *Oakland,* 104 U. S. 450, 461 (1881), it has been clear that the dissident stockholder in that capacity cannot lightly take upon himself the guardian mantle of assertion of claimed corporate rights not being adequately asserted by the board of directors:

"He must make an earnest, not a simulated effort, with the managing body of the corporation, to induce remedial action on their part, and this must be made apparent to the court. If time permits or has permitted, he must show, if he fails with the directors, that he has made an honest effort to obtain action by the stockholders as a body, in the matter of which he complains. And he must show a case, if this is not done, where it could not be done, or it was not reasonable to require it."

While there have been numerous subsequent judicial pronouncements, and refinements, of the principle stated in *Hawes*, and the courts have shown varying degrees of liberality or conservatism in applying the standards permitting the derivative action,[6] essentially the applicable rule has been synthesized in Rule 23.1.

It may be wondered why counsel would not almost routinely take the course of making a formal demand, diligently and in good faith, and in so doing inform the board adequately of the basis of the claim he was asking them to enforce. Adequate time should be allowed for a response and preferably a declination should be secured.[7] On the other hand, we cannot be unmindful of the proclivity of adversaries to raise all conceivably legitimate hurdles and observance of the foregoing procedures, we must admit, would not necessarily avoid a Rule 23.1 challenge.

In any event, from the *Hawes* recognition that if an effort is not made to have the directors take the action, there must be a case shown "where it could not be done, or it was not reasonable to require it" to the Rule 23.1 language that the complaint shall allege "with particularity . . . the reasons for his failure to obtain the action or for not making the effort," it is clear that the prospective derivative plaintiff does not have to launch an effort which would be fruitless or futile.

In this brief on this appeal, Continental states the issue thusly: "Is a stockholder who seeks to bring a derivative suit on behalf of her corporation excused from the Rule 23.1 requirement of prior demand upon the corporate Board, in the absence of a showing of disability of the Board to act impartially and in the best interests of the corporation in determining whether to pursue the supposed cause of action?"

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6. "Although the federal courts generally are lenient in construing this portion of the rule [the demand requirement], occasionally complaints have been dismissed that seem to include sufficient facts to justify the conclusion that the demand requirement had been satisfied." 7A Wright and Miller, Federal Practice and Procedure: Civil § 1831 at 375 (1972).

7. For a general discussion, see Wright and Miller, *supra* at 377.

In accordance with this statement of the issue, much of the argument of Continental is devoted to a demonstration of the good faith business judgment exercised by the Leasco board of directors in connection with the Reliance transaction. For example, Continental argues that "[t]o ignore what actually happened, [which would seem to assume that there was no dispute as to what actually happened in substance as well as form which, of course, is inconsistent with the allegations of the complaint] as plaintiff would have us do, and instead to treat the transactions as loan transactions between the Bank and Leasco, would completely upset the 'pooling of interest' accounting treatment accorded the transactions, with the result that Leasco (and, indirectly, its shareholders including plaintiff) would suffer financial harm of a substantial nature."

If the issue were as broad as Continental would make it, then the matter of "pooling of interest" accounting treatment,[8] as well as other aspects of the exercise of business judgment adverted to, might pose difficult questions, or at least questions which we deem not to be involved here.

The sole, and narrow, issue which we find in this appeal is whether the district court abused its discretion in dismissing the action because of Nussbacher's failure "to meet the demand requirements of Fed. R. Civ. P. 23.1." We do not conceive that the resolution of this issue carries us into the merits questions presented by the matter of business judgment and whether this is a case of the "special character which stockholders may

8. Continental asserts that if the transaction should be construed to be a loan, then Leasco could not continue to account for the acquisition on a "pooling of interests" basis. Nussbacher replies that this argument is a sham and that the significance of pooling of interests accounting is "highly inflated" by Continental. To the extent that the plaintiff is arguing that the method of accounting required due to the structure of a transaction (pooling of interests or purchase method) could not be a sufficient business reason, it would appear that she has misconceived the significance of the differences between these methods. See generally, Accounting Principles Board Opinion No. 16 (1970). The issue of the significance of the effect of the accounting method on the transactions, however, was not reached by the district court and does not compose a part of the issue before us.

bring." *Swanson* v. *Traer,* 249 F. 2d 854, 860 (7th Cir. 1957). These questions may be susceptible to resolution by summary judgment procedure, or they may require a trial. The short answer is that they have not been resolved at the district court level at this time and have no proper place in the appeal now before us.[9]

Turning then to the issue which is before us, we are satisfied that there was sufficient before the district court to preclude it in the exercise of proper discretion from dismissing the case on the 23.1 ground. Upon analysis, it appears to us that Continental is contending in effect that a demand had to be made.[10] This position would make the alternative prong of Rule 23.1 which permits the plaintiff to explain why he made no demand about as meaningless as it would have been for plaintiff to have made a demand in the present case. Not only did the board of

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9. This, of course, does not mean that there may not be cases which show on the face of the complaint that the action does not fall within the ambit of an equitable basis for stockholder intervention. In the present posture of the case, we attach no significance at this time to the extended arguments made to us, pro and con, as to whether the directors could be held liable, either criminally or civilly, with regard to violation of margin requirement regulations. The complaint charges director complicity being directly involved in illegal transactions which were alleged to be to the detriment of the corporation.

Irrespective of the extent of exposure to personal liability that the directors of Leasco might have if the allegations of the complaint should be proven, there would seem to be appropriateness here to the words of Judge Coffin in concurring in *In Re Kauffman Mutual Fund Actions,* 479 F. 2d 257, 269 (1st Cir. 1973), *cert. denied,* 414 U. S. 857:

> "I find it hard to imagine that a director, however, unaffiliated, who had participated, or under these circumstances knowingly acquiesced, in a major transaction, albeit for a corporate purpose, would authorize a suit, effectively against himself, claiming that the transaction violated the federal antitrust laws. Even independent watchdogs cannot be thought ready to sign a confession of that magnitude."

10. "Thus, the demand requirement is not a mere formality; it is a sound principle of corporate democracy designed to assure that major business questions are presented for resolution to those officers elected to manage the affairs of the corporation." Defendant's brief at 26-27.

directors adopt the position at a meeting that they would not have initiated the New York action, identical in practically all respects to the suit filed in Illinois, but the affidavit of the board chairman which was before the district court concluded by referring to "the determination of the Board of Directors of Leasco Corporation that [the Illinois action] maintained by Plaintiff Nussbacher is inconsistent with the best interests of the Corporation." This decision and determination may well be proved to have been a sound evaluation when the merits questions are reached in this litigation; suffice it to say, the message is loud and clear that under no circumstances would the board of directors have approved the corporation bringing the action.

Both the district court and Continental on this appeal rely heavily on *Kauffman, supra.* Irrespective of the correctness of Nussbacher's contention that this case arose under Massachusetts law which "has long been noted for its conservative philosophy with respect to derivative actions" as opposed to more liberal treatment elsewhere, that case involved a significantly different factual situation inasmuch as it was not alleged that the majority unaffiliated directors also participated in or even approved of the acts of which complaint was made. Underlying facts were not shown to support claimed domination by the minority directors and it was held that demand was not excused. It was not sufficient there to speculate under the circumstances claimed that the majority of the board might not decide to take corporate action. Here it was apparent that the board members were inflexible in their position that corporate action against the defendant would not be taken. That, in our opinion, was demonstrated with the particularity required by Rule 23.1.

Accordingly, the judgment of the district court is reversed and this cause is remanded for further proceedings not inconsistent with this opinion.